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BEFORE THE SURFACE TRANSPORTATION BOARD

REPLY COMMENTS
of
MONTANA WHEAT & BARLEY COMMITTEE
COLORADO WHEAT ADMINISTRATIVE COMMITTEE
IDAHO BARLEY COMMISSION
IDAHO WHEAT COMMISSION
OREGON GRAINS COMMISSION
NEBRASKA WHEAT BOARD
SOUTH DAKOTA WHEAT COMMISSION
WASHINGTON BARLEY COMMISSION

STB Ex Parte No. 582 (Sub-1)
Major Rail Consolidation Procedures
June 5, 2000

The above listed parties, referred to as the Wheat, Barley & Grains Commissions, offer these reply comments for consideration by the Board.

ISSUE BACKGROUND

A majority of respondents in this proceeding, including the Wheat Barley & Grains Commissions, concur with the assessment that the "end game" is upon us, and that, accordingly, it is appropriate for the Board to adjust its merger policies to reflect the serious concerns raised by the potential creation of two transcontinental rail monopolies. Among those concerns are that:

1. Today's need for increased competition will remain unmet, and future mergers will further deteriorate competitive opportunities within the rail system.
2. Major service disruptions can be expected to occur as a result of future mega-mergers, yet there may not be enough railroads available to assist in resolving those disruptions.
3. Rail safety could be degraded in future mergers.
4. Cross border mergers could have far reaching impacts heretofore unanticipated by existing policies.

COMPETITION ISSUES

Despite the Class I railroads' efforts to protect their monopoly position, the Board should act decisively to ensure that enhancement of competition a key factor in all future mergers. The preponderance of evidence submitted in this docket, as well as evidence collected in previous dockets, demonstrates that railroads have accrued so much market power that they are able to determine the economic fate of a great number of their customers. While this monopoly may have allowed the railroad industry to meet their revenue requirements up until now, it has come at the expense of their own growth in customer segments that have modal options. This undermines the railroads' revenue potential while ensuring continued poor service.

However, enhancing competition in the railroad industry will result in lower rates, improved service quality, emergence of new products and methods, and as a result, railroads will attract a growing customer base and they, along with their customers and the whole economy, will benefit. Despite the statements made by many of the Class I railroads, evidence shows that, when faced with competition, the railroads can and will invest in infrastructure to increase and protect market share.

Dr. McCormick testifying in the CMA Comments[1] describes the Powder River Basin experiment as proof positive of the positive effects of head-to-head competition in the railroad industry. In that example, BN's costs went down 38.3% and rates went down 28% thus permitting margins and profitability to increase substantially. Margins improved by a full 10.3% and the funds for infrastructure investments became more, not less. Today, both carriers are better off because of rail-to-rail competition for Powder River Basin coal traffic. It should also be noted that in 1982 when competition was introduced and the real capital investment by BN and CNW sky-rocketed in 1983-1985, the year 2000 air standards which reduced coal emissions had not yet been introduced. Therefore, the investment was made to protect market share not because of anticipated increased millennium demand.

Dr. McCormick also explains why competition will not put an end to differential pricing or eliminate capital resources. In fact, Dr. McCormick's statement reinforces the comments of all rail customers: "The real challenge of deregulation has been to find ways to make the transition to competition effective, efficient and timely without creating interim monopoly power and bottlenecks." Through this merger procedure review proceeding, the Board has the opportunity—and the authority—to bring needed competition into the rail system.

WHO HAS RAIL COMPETITION TODAY?
IT IS A MATTER OF HORIZON PERSPECTIVE

As the Board debates the value of preserving existing competition versus increasing competition, it is important to remember that many rail customers who were served by multiple carriers at one time have lost many of those options over the past 20-plus years. For example, farm producers in the west had four major transcontinental railroads serving their markets in the 1970s; and chemical producers in the Texas Gulf coast had three major railroads serving their markets at one time. The implementation of existing merger policy resulted in the captivity these groups experience today. Thus, it is not sufficient to simply attempt to preserve what competition may exist in the year 2000. Merger policy for the future must attempt to reintroduce competition into markets such as these, keeping the historical perspective on rail-to-rail competition in mind.

In addition, as noted by so many commenters, two railroads often are not sufficient to ensure vigorous competition. In fact, two railroads competing in a market may just allow for efficient collusion. The grain producers in the Dakotas have heard Class I railroads state they do not want to compete directly with another dominant Class I out of fear of retaliation by that Class I in some other part of the grain belt where they are the only competitors.

1 CMA Comments dated May 16, 2000 – Verified Statement of Robert E. McCormick, Pages 33-35

FUTURE RAIL MERGERS MAY NOT CREATE EQUALLY COMPETITIVE RAILROADS

As noted by both the U.S. Department of Transportation and U.S. Department of Agriculture, a two-railroad system inherently faces a heightened risk of failure. What would happen in the event of such a failure? Would the public interest be served if only one monopoly railroad was available to serve the entirety of the country's rail transportation demand? Would that remaining monopoly railroad be adequately prepared to intervene to correct the service crisis caused by the failure of the other railroad? Hopefully such questions are rhetorical, but they reinforce how harmful it would be to rely solely on a two-carrier monopoly system. Therefore, the only answer is that the bar must be raised for all future rail mergers. Examination of downstream effects of every merger from here on is the only plausible means for this Board to assure the public interest of the rail customers can be met.

Furthermore, virtually all major railroad mergers in the future will be considered "end-to-end" rather than parallel, thus efficiencies derived from paring operations or elimination of capacity will be limited and the public benefits will become more and more elusive. The only potential benefit to the public from future mergers is if competitive access is an integral portion of merger policy, and the Board's charge continues to be to approve mergers consistent with the public interest and promote a safe and sound rail system.

SERVICE ISSUES - PERFORMANCE

The railroads have made promises they have not been able to keep. The rail system after the recent consolidations is more fragile because of the plant rationalization that has occurred during the mergers. This fragility affects the rail customer as service deficiencies cause failures throughout the integrated network system. Rail customer after rail customer in this proceeding echoed the service deficiencies created in recent mergers has cost rail customers millions of dollars in lost revenues. Railroads must be required to live up to promises made before this Board. Suggestions that the railroads be required to indemnify rail customers and other railroads for costs incurred due to merger-related service interruptions makes good regulatory sense.

SUPPORT OF CERTAIN RECOMMENDATIONS

The Wheat, Barley & Grains Commissions endorse the US Department of Agriculture's suggestion that the Board institute a rebuttable presumption against future major railroad mergers unless the merging railroads can prove mitigation of any adverse consequences of the merger upon rail customers.

In addition, the Commissions endorse the following competitive enhancements suggested by rail customers:

- Keep all rail gateways open and, at the request of a rail customer, open any previously closed gateways
- Compel, upon request from a rail customer, reasonable pricing over all 'bottleneck' segments
- Lift of all "paper barriers" on shortline railroads as they serve as an impediment to interstate commerce
- Develop programs to enhance shortline railroads infrastructure
- Open up all terminals for full and complete access by affected rail customers

- In the event a merged railroad cannot meet its estimates of synergies as stated in applicants hearings, the Board should mitigate damage to rail customers by introducing further competitive enhancements

RAILROAD CUSTOMERS ARE UNIFIED

The rail customer community is increasingly unified about the underlying problems of the rail industry and in general, has coalesced around the idea that public policy must begin to focus on competition as the solution. While individual recommendations of how to best do this may differ, there is general agreement on the direction this policy proceeding should take. Furthermore, all of the recommendations that would promote increased competition improve service and safety, and correct anti-competitive actions of the past, bears serious consideration, and many should be tested in real world applications.

In general, however, upon review of the statements filed in Ex Parte No. 582 (Sub-No. 1), many members of the rail customer community recognize our growing consensus on issues raised by the concentration of railroad market power in the U.S. and the danger of the emergence of two huge monopoly railroads in North America. Our consensus is reflected in the following pro-competitive principles, which should guide the Surface Transportation Board in its development of improved policies and procedures:

- Stronger action must be taken to hold merging railroads accountable for their promises of improved service and more efficient operations.
- The severe service problems that have resulted from past railroad mergers must be prevented and/or mitigated through effective remedies, including performance guarantees, compensation and access to other railroads.
- Current regulatory policies, including the bottleneck decision, the "one-lump" theory, and the "2-to-1" rule, have failed to prevent the reduction of competition among major railroads, which now enjoy unprecedented market power.
- The regulatory policies of the past, which the STB has recognized as inadequate and which even many railroads are now recognizing as flawed, should be replaced by new policies aimed at promoting competition.
- Access remedies such as trackage rights and switching on fair and economic terms should be more readily available, whether or not there are future mergers.
- Contractual and operational barriers to competition from smaller railroads should be eliminated or reduced, whether or not there are future mergers.
- Gateways for all major routings should remain open on reasonable terms.
- Adverse impacts of rail consolidations on the safety of rail operations and on the interests of rail labor should be mitigated.
- Cross-border mergers should not interfere with effective regulation and the enhancement of competition; and
- Railroad mergers can no longer be considered in isolation.

The need for improved and enhanced competition along these lines is so strong and immediate that the STB should use the full extent of its authority to revise its policies consistent with these principles. The Board's efforts in Ex Parte No. 582 (Sub-No. 1) should include, but not be limited to, all of the recommendations in the proceeding that would:

1. Increase competition among railroads;
2. Improve service and safety; and
3. Address any problems or flaws—present or future—that result directly or indirectly from rail mergers.

Recognizing that the Board may not have the necessary authority to fully achieve comprehensive policy reform consistent with all of the above-listed principles, the rail customer community will continue to press for congressional action that would provide the necessary legislative direction to achieve these principles.

Submitted by:

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CERTIFICATE OF SERVICE

I hereby certify that the above described Reply Comments of the Wheat, Barley & Grains Commissions has been duly served on all Party of Record identified on service list via first class mail in the United States Postal Service this 5th day of June, in the USPS station in Billings, Montana 59101.

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